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DEPARTMENT FOR EEB/TPP/ABT/ATP JANET SPECK

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SUBJECT: RESPONSE: IMPACT OF RISING FOOD/COMMODITY PRICES -
KAZAKHSTAN

REF: STATE 39410

¶1. (SBU) This cable constitutes post's response to reftel, which requested specific information regarding the impact in host country of rising food and agricultural commodity prices.

¶2. (SBU) DEMAND: The most important foods and agricultural commodities consumed in Kazakhstan include flour, bread, meat (beef, pork, horsemeat, and mutton), chicken, butter, sunflower oil, milk, eggs, potatoes, rice and sugar. According to Kazakhstan's National Statistics Agency, prices on these products rose by 26.6 percent during the second half of 2007. Prices on fruits and vegetables, a large portion of which are imported from neighboring countries, rose significantly as well: apples by 42 percent, cabbage by 45 percent, tomatoes by 29 percent. The reasons for food price rises in Kazakhstan are multifold. A high economic growth rate over the past several years has pushed up consumer purchasing power, thus generating an increased demand for specific food products. Increased demand for meat and daily products has led to increased demand for grain to feed livestock.

¶3. (SBU) SUPPLY: Increased agricultural commodity demand and higher prices have led to increased domestic investment in agriculture, more government support for the sector, and utilization of additional farmland to expand crop production.

In April 2008, the government imposed a temporary ban on the export of wheat (though not of flour) effective through September 1, at which time the government will decide whether to lift the ban, taking into account the summer wheat harvest. The temporary export ban was motivated by the government's desire to ensure adequate domestic wheat supply and to keep domestic prices down on wheat and wheat products.

Kazakhstan must ultimately return to exporting, as annual wheat production far exceeds consumption. In fact, Kazakhstan is the world's fifth largest wheat exporter. In general, agricultural commodity supply in Kazakhstan is impacted by ineffective land use, state subsidies for inefficient large farms at the expense of smaller family farms, and bottlenecks in food supply chains such as shortages of storage facilities that contribute to crop losses. There are also high transportation costs and administrative barriers that make food production expensive.

Grain production in Kazakhstan is highly dependent on weather conditions.

¶4. (SBU) POLITICAL IMPACT: There have been small protests against rising bread prices in Kazakhstan's largest city, Almaty, but no major demonstrations. There has been no measurable affect on the stability of the government, nor has there been a meaningful impact on relations between classes, ethnic groups, or urban vs. rural dwellers.

¶5. (SBU) ECONOMIC IMPACT: Kazakhstan faces a double challenge with regard to the current food inflation as high

levels of natural resource-fueled growth since 2000 have lead to a steady rise in overall inflation from 6.7 percent in 2004 to 18.8 percent in 2007. The 2007 figure was well above the initial 7 percent inflation projection of the National Bank of Kazakhstan. There has been no significant impact of agricultural price increases on Kazakhstan's trade balance, as agricultural products make up only 10 percent of overall external trade turnover. As Kazakhstan is a major energy exporter, its private sector development and medium-term economic growth prospects are principally influenced by oil and gas prices, though the global financial crisis has had an important impact on shorter-term growth. Kazakhstan's agricultural sector had a growth rate of 8.4 percent during 2007. Further increases in agricultural production can make an important contribution to the country's economic diversification strategy.

16. (SBU) ENVIRONMENTAL IMPACT: Thus far, there has been no direct environmental impact apart from utilization of additional farmland to expand crop production in response to rising demand and rising prices. It remains unclear whether plans to manufacture biofuels from wheat and corn will be reconsidered.

17. (SBU) GOVERNMENT POLICY RESPONSE: In response to rising agricultural commodity and food prices, the government announced national food security to be a priority in 2008 and increased budget allocations for agricultural production. Kazakhstan's Kazyna National Development Fund has provided a \$200 million a credit line for agricultural producers. The government has also increased subsidies for the production of oil-bearing crops, sugar beet, and corn, and has subsidized

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purchase of seeds and fuel. In addition, Prime Minister Masimov proposed a new law on food security in order to prevent food shortages and the creation of a special reserve for major food products. The government has also created so-called "stabilization funds" to store up basic food products (bread, flour, sugar, oil) in case of shortages or speculation. Some regional government administrations have signed MOU's with large food producers to stabilize prices and have provided discounts and targeted cash transfers to vulnerable groups. In October 2007, the government imposed a ban on the export of oil-bearing seeds in response to a shortage of sunflower seeds; this ban has been extended to October 1, 2008. As noted in para 3, in April 2008, the government imposed a temporary ban on the export of wheat (though not of flour) effective through September 1, at which time government will decide whether to lift the ban, taking into account the summer wheat harvest.

18. (SBU) IMPACT ON POST PROGRAMS: USAID has one regional technical assistance program in the agricultural sector --the "Regional Agricultural Linkages Project" -- which attempts to strengthen supply chain linkages among the five Central Asian countries. The focus is on wholesalers, packagers, and distributors of agricultural products. Thus far, the food price rises have not affected this assistance program.

19. (SBU) POLICY PROPOSALS: Based on a policy study completed last year to which the USG contributed and which provides guidance consistent with USG assistance, the World Bank recently made a presentation to the Kazakhstani government which reviewed and assessed policy options with respect to controlling agricultural prices, increasing supply, reducing demand, protecting consumers, and reducing marketing margins. The policy choices Kazakhstan faces will determine whether it will pursue an outward-looking approach to food security -- increasing agricultural exports to generate the income needed to contribute to imports -- or will turn inward to regulate prices in its domestic market, which will undermine its long-term competitiveness and sector productivity. While all of the choices available to the Kazakhstani government have both pros and cons, broadly speaking, we would advise the Kazakhstanis to avoid market-distorting interventions,

such as price controls and export bans. The most efficient and least market distorting option would be focusing on social support programs which directly assist the most vulnerable parts of the population. These can include direct cash transfers to the needy, food stamps, and food-for-work programs. The World Bank's report also recommends scaling down input subsidies and instead strengthening research and development, training and education, and rural infrastructure, including irrigation and transportation to improve farm efficiency. Furthermore, the report recommends improving the economic enabling environment for an efficient agricultural sector by not skewing subsidies towards large farms and avoiding discretionary powers of local governments to control prices in local bazaars. The report further recommends improving the functioning of the land market by redistributing agricultural land for a nominal fee while gradually raising the land tax, which would create incentives to increase efficiency.

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